UNITED STATES BANKRUPTCY COURT

DISTRICT OF HAWAII

In re	)	Case No. 03-00922
	)	Chapter 13
FRED WAI MUN CHANG,	)	
	)	
Debtor.	)	
_____	)	

FINDINGS OF FACT AND CONCLUSIONS OF LAW ON OBJECTION TO CONFIRMATION OF CHAPTER 13 PLAN

On August 6, 2003, Debtor Fred Wai Mun Chang filed a First Amended Chapter 13 Plan. On August 27, 2003, Creditors Gima Termite Control, Inc. ("Gima Termite"), and Sharon Y. J. Won filed their objection to confirmation of the Debtor's plan. Because the objection raised disputed factual issues, the matter was set for an evidentiary hearing.

An evidentiary hearing was held on June 1, 2, 3, 4, and 22, 2004. Bradley R. Tamm, Esq., and Rodney Uchida, Esq., represented the Debtor, and Jeffery A. Griswold, Esq., represented Creditors Gima Termite and Sharon Won.

Based on the evidence presented, the court makes the following:

FINDINGS OF FACT

1. The Debtor and David Sunagawa formed Honolulu Termite & Pest Control Company, Inc. ("Honolulu Termite"), in 1992, to engage in the business of providing termite and pest control services. Mr. Sunagawa arranged for his company, Gima Termite, to fund Honolulu Termite's startup costs. He also helped to prepare Honolulu Termite's tax returns. The Debtor provided operational and sales management. Honolulu Termite and Gima Termite operated out of the same location.

2. The Debtor held 50 percent of the stock of Honolulu Termite. Mr. Sunagawa arranged for Sharon Won, Mr. Sunagawa's then girlfriend (and now his wife), to hold the other 50 percent. Until about April 1999, Ms. Won had no role in the business (other than that of a passive shareholder). From May 1996 through May 1999, Honolulu Termite paid her $250 per week. She provided no services to the company; the payments were on account of commissions earned by Mr. Sunagawa.

3. Honolulu Termite lost money for the first few years of its existence and never made a significant profit.[1] Until about 1995, Gima Termite provided the money which Honolulu Termite required to stay in business.

4. The Debtor accepted cash payments from some of Honolulu Termite's customers. He testified that he used most of the cash to pay Honolulu Termite's expenses and that he kept "a little" for himself. He testified that Mr. Sunagawa and Ms. Won knew of and approved this practice and that he shared the cash with Mr. Sunagawa, but they both denied it. He did not include the cash he kept on his income tax returns until he filed amended returns shortly before he commenced his bankruptcy case.

5. As a result of a freak accident which resulted in a large personal injury tort claim against Honolulu Termite, Honolulu Termite's insurance premiums increased substantially in 1998. Honolulu Termite could not afford the increased premium.

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[1]An income and expense statement for 1995 (included in Exhibit 2006) purports to show that Honolulu Termite earned an after-tax profit of $247,784.03 during that year. Unlike the income statements for the other years, however, the 1995 statement does not include an expense line for chemicals. The 1996 statement shows chemical expense of $240,499.71. If the company spent the same amount for chemicals in 1995, its reported profit would have been nearly eliminated. I find that the 1995 statement is not accurate and that Honolulu Termite probably never earned a significant profit.

6. The Debtor, with the consent and knowledge of Mr. Sunagawa, sought out Terminix Inc. ("Terminix") as a potential buyer of Honolulu Termite. Eventually, in March 1999, Terminix offered to pay approximately $1,500,000, about $500,000 of which would have been payable in a lump sum at closing in exchange for Honolulu Termite's assets and customer list, and the balance of which would have been paid in monthly installments over a ten year period to the Debtor and Ms. Won in consideration of a non-compete agreement.

7. Several employees of Honolulu Termite were not willing to work for Terminix. Some of the employees decided to work for Gima Pest Control, Inc., another company controlled by Mr. Sunagawa. Another employee, George Brown, initially wanted to work for Gima Pest Control, but decided to form his own company after he and Mr. Sunagawa could not agree on Mr. Brown's compensation. In April 1999, Mr. Brown and Joseph Souza, also an employee of Honolulu Termite, established Diamond Head Termite, Inc. ("Diamond Head Termite").

8. As is customary in Hawaii's termite and pest control industry, Honolulu Termite did not have any agreements with its employees which precluded the employees from competing with Honolulu Termite or soliciting Honolulu Termite's customers after they left the company's employ.

9. In June 1999, when Terminix learned that several of Honolulu Termite's employees did not intend to remain with the business after the proposed sale to Terminix, Terminix withdrew its offer.

10. The relations between the Debtor on the one hand and Mr. Sunagawa and Ms. Won dissolved in acrimony. Both sides blamed the other for the failure of the lucrative Terminix sale. Neither the Debtor nor Mr. Sunagawa and Ms. Won made any further attempts to sell the business. Instead, the Debtor gave up on Honolulu Termite. He did so partly because Honolulu Termite could not fund its continuing losses and he did not think that the business could be made profitable. He was also angry with Mr. Sunagawa and Ms. Won for (in his view) having ruined the Terminix sale, and therefore he did not want to continue in business with them.

11. It is unclear that anyone could have salvaged Honolulu Termite after Terminix withdrew its offer. Honolulu Termite was apparently never profitable, and its losses grew because of the increase in the insurance premiums. During the pendency of the Terminix negotiations, several key employees of Honolulu Termite left the company (or made it clear that they intended to leave), taking their customers with them. It is doubtful that, even under the best

management, Honolulu Termite could have survived the loss of revenues and increase of expenses.

12. During the summer of 1999, the Debtor turned over to Diamond Head Termite the entire business of Honolulu Termite. Over Ms. Won's objection, the Debtor moved all of Honolulu Termite's assets from the premises which Honolulu Termite had shared with Gima Termite to the premises occupied by Diamond Head Termite. The Debtor became an employee of Diamond Head Termite (and he continued to draw a salary from Honolulu Termite as well for some months). With the Debtor's permission, Mr. Brown began to operate Honolulu Termite's business. He had full authority to write checks on Honolulu Termite's accounts and he did so frequently to pay expenses for both Honolulu Termite and Diamond Head Termite.

13. The Debtor caused Honolulu Termite to transfer five or six vehicles and some used equipment and inventory to Diamond Head Termite, in return for Diamond Head Termite's agreement to make the loan and lease payments on the vehicles. Although Diamond Head Termite made some payments on the vehicles after the transfer took place, the Debtor and Mr. Brown also caused Honolulu Termite to make some of the payments. The Debtor and Mr. Brown testified that the Debtor arranged for Diamond Head Termite to provide warranty

and other services which Honolulu Termite was obligated to provide to customers, that Honolulu Termite was supposed to reimburse Diamond Head Termite for these services, and that Diamond Head Termite's obligation to pay for Honolulu Termite's vehicles was sometimes applied as an offset against Honolulu Termite's obligation to pay for the services to customers. Both the Debtor and Mr. Brown testified, however, that they never checked, and did not keep any records from which one could determine, that the respective companies paid the correct amounts. Instead, it appears that Mr. Brown and the Debtor used the funds and assets of Honolulu Termite and Diamond Head Termite indiscriminately and without making a meaningful attempt to keep the assets, liabilities, income, expenses, or operations of the two corporations separate.

14. The Debtor physically moved all of Honolulu Termite's business records, including all customer information, to the premises of Diamond Head Termite. Some customers of Honolulu Termite became customers of Diamond Head Termite. Other Honolulu Termite customers became customers of Gima Pest Control, one of Mr. Sunagawa's companies. Diamond Head Termite and Gima Pest Control did not pay anything to Honolulu Termite for Honolulu Termite's customers. It is customary in Hawaii's termite and pest control industry for customers to follow the salespeople and technicians who serve them as the

salespeople and technicians move from one employer to another. Also in accordance with customary industry practice, Honolulu Termite did not have any agreements with its employees which would limit the employees' ability to take customers with them after they left Honolulu Termite's employ. Most of the customers who shifted from Honolulu Termite to Diamond Head Termite had connections with the Debtor or Mr. Brown. Most of the customers who switched from Honolulu Termite to Gima Pest Control had connections with the Honolulu Termite employees who moved to Gima Pest Control.

15. The Debtor arranged for Honolulu Termite and Diamond Head Termite to pay the bills for Honolulu Termite's telephone and fax numbers after Honolulu Termite had ceased operations. He did so partly to enable Honolulu Termite's customers to continue to request service to which they were entitled and partly so he could direct any sales leads to Diamond Head Termite.

16. For a few months, Diamond Head Termite used business forms which were crude "scissors and paste" modifications of Honolulu Termite's forms. There was no evidence to suggest, however, that the Honolulu Termite business forms had more than nominal value.

17. Honolulu Termite had a contract with the United States Army which was "set aside" for small businesses and therefore could not be sold to

Terminix. The Debtor and Mr. Brown arranged for the Army to transfer the contract to Diamond Head Termite in October 1999. Honolulu Termite (through Mr. Chang) and Diamond Head Termite (through Mr. Brown) represented to the Army that, as of October 25, 1999, Honolulu Termite had transferred all of its assets to Diamond Head Termite.[2] Diamond Head Termite did not continue the contract beyond the first year because it found the contract to be unprofitable.

18. Ms. Won and Gima Termite claim that the Debtor has an undisclosed ownership interest in Diamond Head Termite. This contention was not proven.

19. Gima Termite and Sharon Won commenced a civil action against Honolulu Termite and the Debtor in Hawaii state court on May 29, 2001. Gima Termite Control, Inc., et al. v. Honolulu Termite, Inc., Civ. 01-1-1634-05 (1st Cir. Haw.). Gima Termite alleged a claim for monies that it loaned to Honolulu Termite. Sharon Won alleged a claim for the Debtor's misappropriation or embezzlement of funds from Honolulu Termite.

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[2]Mr. Chang and Mr. Brown also signed and submitted to the Army another document in which Mr. Chang represented that he (not Honolulu Termite) owned the contract and that he would receive ten percent of all payments under the contract in consideration of the transfer. Mr. Chang testified that he never received any such commission payments, that any such commissions should have been payable to Honolulu Termite, and that he did not know whether Honolulu Termite received any such commissions. Mr. Brown testified (and I find) that no such commissions were ever paid to anyone.

20. The attorney representing the Debtor in the state court litigation advised the Debtor that it would cost $80,000 to $150,000 to defend the Debtor in the litigation. The Debtor concluded that, win or lose, the litigation would ruin him. He therefore sought advice from bankruptcy counsel.

21. In 2002, on the advice of his bankruptcy counsel, the Debtor sold his only substantial his nonexempt asset, his condominium residence. He used the net proceeds of $85,897.32 to purchase an exempt annuity and make two years' maximum contributions to an exempt individual retirement account.

22. The Debtor filed his bankruptcy petition on March 28, 2003. This is the Debtor's first bankruptcy filing. At the time of the filing of the Petition, a motion was pending in the state court case for discovery sanctions, including the entry of default against the Debtor.

23. The Debtor failed to disclose in his schedules of assets a 1987 Honda motor scooter, valued at approximately $490.00, two bicycles valued at $100.00, and a security deposit with his landlord in the sum of $800.00. The failure to schedule the motor scooter was the result of an error by the Debtor's counsel. The failure to list the bicycles and the security deposit was an inadvertent error by the Debtor. None of these errors is material. The Debtor could have claimed the motor scooter and the bicycle as fully exempt. The security deposit is

subject to the landlord's claim and therefore would not have produced any recovery for other creditors.

24. The Debtor's Statement of Financial Affairs disclosed that in June 2001 the Debtor transferred ownership of his 1995 Honda Gold Wing motorcycle valued at $6,000 to George Theofanis, a friend of the Debtor. Notwithstanding the transfer of title, the Debtor retained full possession and use of the motorcycle and continued to pay all of the registration, maintenance, and insurance costs for the motorcycle. The Debtor gave inconsistent testimony about this transaction. At times, he repeated his assertion that he transferred the motorcycle to Mr. Theofanis in satisfaction of a business debt of $15,000. At other times, he seemed to say that he transferred the motorcycle to Mr. Theofanis to secure the debt; he said that he hoped someday to repay the debt and regain ownership of the motorcycle. The Debtor offered no evidence to substantiate his testimony that he ever owed a debt to Mr. Theofanis. In reality, the Debtor continues to be the true owner of the motorcycle; assuming that the Debtor ever owed a valid debt to Mr. Theofanis, he is a secured creditor with a security interest in the motorcycle; and the Debtor's statements about the transfer of the motorcycle to Mr. Theofanis in satisfaction of a debt are material and incorrect. (I cannot

determine on this record, however, whether the Debtor made these statements knowingly or intentionally.)

25. The objecting creditors argue that the Debtor failed to disclose all of his income. They offered the testimony of an expert accountant to show that the amounts deposited in the Debtor's bank accounts during recent years were greater than his reported income. This contention was not proven. The debtor has not made any material misstatements in disclosing his historical and projected future income.

26. The First Amended Chapter 13 Plan provides for monthly payments of $130.00 over 36 months, and a lump sum payment of $15,000 from the liquidation of exempt assets within one year of plan confirmation.

27. The Debtor is forty-nine years old. He has no net retirement savings. He has worked as a salesman for about thirty years. He currently earns a salary of approximately $36,000 per year. There is little likelihood that his income will increase substantially in the future.

Based on the foregoing findings of fact, the court makes the following:

CONCLUSIONS OF LAW

A. Chapter 13 Eligibility

1. "Only an individual with regular income that owes, on the date of filing of the petition, noncontingent, liquidated, unsecured debts less than $269,250 . . . may be a debtor under Chapter 13." 11 U.S.C. § 109(e).

2. A claim is "liquidated" under section 109(e) if the amount of the claim is subject to ready determination. A dispute regarding liability does not render the claim unliquidated. Slack v. Wilshire Ins. Co. (In re Slack), 187 F.3d 1070, 1073-1074 (9th Cir. 1999). Whether a debt is subject to ready determination depends on whether the amount is easily calculable or whether an extensive hearing is needed to determine the amount of the debt. Ho v. Dai Hwa Elecs. (In re Ho), 274 B.R. 867, 873 (B.A.P. 9th Cir. 2002).

3. The claims asserted by Gima Termite and Ms. Won against the Debtor are not liquidated within the meaning of section 109(e). Although their claims against Honolulu Termite may be liquidated (because they are based on loans made to the corporation, the amount of which can be proven through appropriate records), their claims against the Debtor require them to establish the extent to which he is liable for the corporation's debt based on theories of corporate veil-piercing, embezzlement, or misappropriation. An extensive hearing

would be required to determine the amount (if any) of the Debtor's liability on these claims. See In re Slack, 187 F.3d 1070 (9th Cir. 1999).

4. The Debtor is eligible for chapter 13 relief under section 109(e).

B. The Good Faith Requirement

5. In order to confirm a chapter 13 plan, the court must find that the debtor proposed the plan in good faith. 11 U.S.C. § 1325(a)(3).

6. The debtor has the burden of showing that the plan is proposed in good faith. Fidelity & Cas. Co. v. Warren (In re Warren), 89 B.R. 87, 90 (B.A.P. 9th Cir. 1998). The debtor's burden of establishing that a plan is proposed in good faith is especially heavy where the debtor seeks a chapter 13 "superdischarge" of a debt that would be nondischargeable in chapter 7, and where the debtor has engaged in prefiling conduct that is criminal and/or repugnant to societal standards. Id. "A bankruptcy court should pay particular scrutiny to the debtor's good faith when the plan proposes nominal repayment and a nondischargeable debt is present." Washington Student Loan Guaranty Assoc. v. Porter (In re Porter), 102 B.R. 773, 776 (B.A.P. 9th Cir. 1989) (citing In re Warren, 89 B.R. at 94).

7. The court must make its "good faith" determination based on a "review of the totality of the circumstances." The court must determine "whether the debtor misrepresented facts in his/her plan, unfairly manipulated the Bankruptcy Code or otherwise proposed his/her chapter 13 plan in an equitable manner." Goeb v. Heid (In re Goeb), 675 F.2d 1386, 1390 (9th Cir. 1982).

8. The non-exhaustive list of factors that should be considered in determining the debtor's good faith are:

a. The amount of the proposed payments and the amounts of the debtor's surplus;

b. The debtor's employment history, ability to earn, and likelihood of future increases in income;

c. The probable or expected duration of the plan;

d. The accuracy of the plan's statements of the debts, expenses and percentage of repayment of unsecured debt, and whether any inaccuracies are an attempt to mislead the court;

e. The extent of preferential treatment between classes of creditors;

f. The extent to which secured claims are modified;

g. The type of debt sought to be discharged, and whether any such debt is nondischargeable in Chapter 7;

h. The existence of special circumstances such as inordinate medical expenses;

i. The frequency with which the debtor has sought relief in bankruptcy;

j. The motivation and sincerity of the debtor in seeking Chapter 13 relief; and

k. The burden which the plan's administration would place upon the trustee. In re Padilla, 213 B.R. 349, 352-353 (B.A.P. 9th Cir. 1997), (citing In re Warren, 89 B.R. 87, 93 (B.A.P. 9th Cir. 1988)).

9. Applied to this case, these factors point in varying directions.

a. Amount of proposed payments and surplus. The plan payments are modest in absolute terms and in comparison to the amount claimed by the objecting creditors, but they represent more than the surplus of the Debtor's income over his reasonable expenses.

b. Debtor's earning history and potential. The Debtor appears to be earning as much as he reasonably could earn given his education,

training, skill, and experience, and it is not likely that his income will increase substantially in the future.

c. Plan duration. The plan has the minimum thirty-six month term, rather than the maximum sixty month term.

d. Accuracy of plan statements and projections. The plan itself contains no material or deliberate misstatements. As noted above, however, the Debtor's testimony and assertions in the Statement of Financial Affairs about the Debtor's interest in the Gold Wing motorcycle were incorrect and material.

e. Preferential treatment of creditors. The plan does not prefer any creditors except to the extent required by bankruptcy law.

f. Modification of secured claims. The plan does not provide for the modification of any secured claims.

g. Superdischarge. The objecting creditors argue that, in a chapter 7 case, their claims would not be dischargeable under sections 523(a)(4) and (a)(6).

Section 523(a)(4) bars the discharge of any debt "for fraud or defalcation while acting in a fiduciary capacity, embezzlement, or larceny." The objecting creditors argue that the Debtor was a "fiduciary" because he served as an officer and director of Honolulu Termite. It is not certain that the duties of a

director or officer under Hawaii law are sufficient to qualify for "fiduciary" status within the limited meaning of section 523(a)(4). Compare In re Jacks, 266 B.R. 728, 737 (B.A.P. 9th Cir. 2001) (applying California law), with In re Hultquist, 101 B.R. 180, 185 (B.A.P. 9th Cir. 1989) (applying Washington law).

Section 523(a)(6) bars the discharge of any debt "for willful and malicious injury by the debtor to another entity or to the property of another entity." In order to prevail under this section, the creditor must establish that the debtor subjectively intended to inflict harm on the creditor or subjectively believed that his conduct was substantially certain to harm the creditor. Negligence or even recklessness are not sufficient. In re Jercich, 238 F.3d 1202, 1208 (9th Cir. 2001). It is not certain that the objecting creditors could carry this burden.

I need not determine with finality, however, whether the debt would or would not be dischargeable in a chapter 7 case. The test of good faith is broader than that and requires an inquiry into the "nature of the debt," including but not limited to whether the debt would be dischargeable in a chapter 7 case.

The Debtor's conduct after the failure of the Terminix sale was selfish and irresponsible. The Debtor concedes that his conduct was negligent, and perhaps even grossly negligent. The Debtor made essentially no effort to effect an orderly windup of Honolulu Termite's affairs or to deal openly with Ms. Won, his

fellow shareholder. Instead, he turned everything over to his new employer, Diamond Head Termite, so that Diamond Head Termite could take advantage of whatever it could salvage from the rubble. The Debtor's decision to proceed in this fashion was motivated at least in part by his personal animus for Mr. Sunagawa and Ms. Won. It may be that, at that point, no one could have saved Honolulu Termite or preserved anything for its creditors and stockholders. The Debtor did not even try, however, to protect anyone other than himself. Even if the Debtor's liability for this misconduct could be discharged in a chapter 7 case, the conduct still deserves condemnation and it weighs heavily against him in the good faith calculus.

h. Special circumstances. The Debtor faced litigation, the expense of which likely would have consumed all of his assets even if he won.

i. Frequency of filing. This is the Debtor's first bankruptcy case.

j. Debtor's motivation and sincerity. Although the Debtor's conduct and motives in connection with the failure of Honolulu Termite were dishonorable, his motivation in this case appears to be legitimate and sincere. He faces financial problems which he cannot solve except through a bankruptcy

proceeding. With the exception of his misstatements concerning the Gold Wing motorcycle, his conduct in connection with this case cannot be faulted.

k. Administrative burden. This plan would not create any unusual administrative problems for the trustee.

10. Another aspect of this case does not fall squarely within any of the factors listed in Padilla but is nonetheless part of the totality of the circumstances which I must consider in assessing the Debtor's good faith. In the year before the Debtor filed his petition, acting on the advice of counsel, the Debtor converted his only substantial non-exempt asset (the equity in his home) into exempt form. The Debtor correctly points out that such conduct, taken alone, is not sufficient to deny a chapter 7 discharge or preclude a finding of good faith in chapter 13. Nevertheless, the Debtor's decision to put approximately $85,000 out of the reach of his creditors, and then to restore only $15,000 of that amount to the creditors by way of his plan, weighs against a finding of good faith.

11. Based on the totality of the circumstances, including but not limited to the Padilla factors, I conclude that the Debtor's Amended Chapter 13 Plan was not proposed in good faith.

12. It may be possible for the Debtor to propose a plan which meets the good faith test. Such a plan would probably have to exceed the minimum

duration of thirty six months, correct the Debtor's misstatements concerning the Gold Wing motorcycle and deal appropriately with that asset and its value, and provide for a substantially larger contribution from the assets which the Debtor converted to exempt form on the eve of bankruptcy. It will be up to the Debtor, however, to decide whether to propose another plan and what terms it should include, and it will then be up to the creditors and the standing trustee to evaluate that plan. I will express no firm opinions on this subject until the appropriate time.

13. The court will enter a separate order, in the usual form, denying confirmation of the First Amended Chapter 13 Plan.

DATED: Honolulu, Hawaii, September 23, 2004.

/s/ Robert J. Faris
United States Bankruptcy Judge